

# **Report of the auditor-general to the Eastern Cape Provincial Legislature and the council on the Ikwezi Local Municipality**

## **Report on the financial statements**

### **Introduction**

1. I was engaged to audit the financial statements of the Ikwezi Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2015, the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget and actual amounts for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

### **Accounting officer's responsibility for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2014 (Act No. 10 of 2014) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor-general's responsibility**

3. My responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with International Standards on Auditing. Because of the matter described in the basis for disclaimer of opinion paragraph, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

### **Basis for disclaimer of opinion**

#### **Limitations on the financial statements**

4. I was unable to obtain sufficient appropriate audit evidence regarding the financial statements as a whole, as the financial statements were presented for audit purposes without accurate and complete underlying accounting records. I was unable to audit the financial statements by alternative means. Consequently, I was unable to determine whether any adjustments relating to the financial statements as a whole were necessary.

## **Disclaimer of opinion**

5. Because of the significance of the matter described in the basis for disclaimer of opinion paragraph, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

## **Additional matter**

6. I draw attention to the matter below. My opinion is not modified in respect of this matter.

## **Withdrawal from the engagement**

7. Due to the limitation imposed on the scope of the audit by management, I have disclaimed my opinion on the financial statements. But for the legislative requirement to perform the audit of the municipality, I would have withdrawn from the engagement in terms of International Standards on Auditing.

## **Report on other legal and regulatory requirements**

8. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives for selected key performance areas presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to identify reportable findings as described under each subheading, but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

## **Predetermined objectives**

9. I was unable to perform procedures to obtain evidence about the usefulness and reliability of the reported performance information, as the municipality did not submit its annual performance report for auditing, as required by section 46 of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA) and section 121(3)(c) of the MFMA.

## **Compliance with legislation**

10. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My material findings on compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

## Strategic and performance management

11. The local community was not consulted by means of a municipal-wide structure for community participation in drafting and implementing the integrated development plan (IDP), as required by section 28 of the MSA and municipal planning and performance management regulation 15(1)(a)(i).
12. The municipality did not give effect to its IDP and conduct its affairs in a manner consistent with its IDP, as required by section 36 of the MSA, section 21(2)(a) of the MFMA and municipal planning and performance management regulation 6.
13. The IDP was not annually reviewed by the council based on the assessment of its performance measurements and changing circumstances, as required by section 34 of the MSA and municipal planning and performance management regulations 3 and 11.
14. The municipality did not establish a performance management system, as required by section 38(a) of the MSA.
15. Key performance indicators, including input, output and outcome indicators, were not set out in the IDP in respect of each of the development priorities and objectives, as required by section 41(1)(a) of the MSA and municipal planning and performance management regulations 1 and 9(1)(a).
16. Measurable performance targets for the financial year were not set out in the IDP, for each of the key performance indicators and with regard to each of the development priorities or objectives, as required by section 41(1)(b) of the MSA and municipal planning and performance management regulation 12(1) and 12(2)(e).
17. The service delivery and budget implementation plan used for implementing the municipality's delivery of municipal services and annual budget did not indicate:
  - projections for each month of the revenue to be collected (by source) and the operational and capital expenditure (by vote)
  - service delivery targets and performance indicators for each quarter, as required by section 1 of the MFMA.
18. The performance of the municipality was not assessed during the first half of the financial year, as required by section 72(1)(a)(ii) of the MFMA.
19. An annual performance report was not prepared for the financial period under review, as required by section 46 of the MSA.
20. The performance management system and related controls were inadequate, as it did not describe and represent the processes of performance planning, monitoring, measurement, review, reporting and improvement and how it is to be conducted, organised and managed, including determining the roles of the different role players, as required by section 38 of the MSA and municipal planning and performance management regulation 7.

## Annual financial statements and annual report

21. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements identified by the auditors in the submitted financial statements were not adequately corrected and the supporting records could not subsequently be provided, which resulted in the financial statements receiving a disclaimer of audit opinion.
22. Financial statements were not submitted for auditing within two months after the end of the financial year, as required by section 126(1)(a) of the MFMA.
23. The oversight report, containing comments on the annual report, was not adopted by the council within two months from the date on which the 2014-15 annual report had been tabled, as required by section 129(1) of the MFMA.

## Revenue management

24. An adequate management, accounting and information system was not in place to account for revenue and debtors, as required by section 64(2)(e) of the MFMA.
25. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.
26. Revenue due to the municipality was not calculated on a monthly basis, as required by section 64(2)(b) of the MFMA.
27. Accounts for municipal tax and municipal service charges were not prepared, as required by section 64(2)(c) of the MFMA.
28. Sufficient audit evidence could not be obtained that interest had been charged on all accounts in arrears, as required by section 64(2)(g) of the MFMA.

## Asset management

29. An adequate management, accounting and information system was not in place to account for assets, as required by section 63(2)(a) of the MFMA.
30. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) of the MFMA.

## Conditional grants

31. The municipal infrastructure grant allocation was not spent in accordance with the applicable grant framework, in contravention of section 17(1) of DoRA.

32. The municipality did not evaluate its performance in respect of programmes funded by the municipal infrastructure grant allocation, as required by section 12(5) of DoRA.
33. The municipal systems improvement grant allocation was not spent in accordance with the applicable grant framework, in contravention of section 17(1) of DoRA.
34. The municipality did not evaluate its performance in respect of programmes or functions funded by the municipal systems improvement grant allocation, as required by section 12(5) of DoRA.

## Internal audit

35. The internal audit unit did not function as required by section 165(2) of the MFMA, in that:
  - it did not prepare a risk-based audit plan and an internal audit programme for the financial year under review
  - it did not report to the audit committee on the implementation of the internal audit plan
  - it did not advise the accounting officer or report to the audit committee on matters relating to risk, risk management and loss control.
36. The internal audit unit did not advise the accounting officer or report to the audit committee on matters relating to compliance with the MFMA, DoRA and other applicable legislation, as required by section 165(2)(b)(vii) of the MFMA.

## Audit committee

37. The audit committee did not advise the council or accounting officer on matters relating to internal financial control and internal audits, risk management, accounting policies, effective governance, performance management and performance evaluation, as required by section 166(2)(a) of the MFMA.
38. The audit committee did not advise the council or accounting officer on matters relating to the adequacy, reliability and accuracy of financial reporting and information, as required by section 166(2)(a)(iv) of the MFMA.
39. The audit committee did not advise the council or accounting officer on matters relating to compliance with legislation, as required by section 166(2)(a)(vii) of the MFMA.
40. The audit committee did not review the annual financial statements to provide the council with an authoritative and credible view of the financial position of the municipality, its efficiency and effectiveness as well as its overall level of compliance with legislation, as required by section 166(2)(b) of the MFMA.
41. The audit committee did not respond to the council on the issues raised in the audit reports of the auditor-general, as required by section 166(2)(c) of the MFMA.
42. The audit committee did not review the municipality's performance management system or make recommendations to the council, as required by municipal planning and performance management regulation 14(4)(a)(ii).

43. The audit committee did not review the quarterly internal audit reports on performance measurement, as required by municipal planning and performance management regulation 14(4)(a)(i).
44. The audit committee did not submit, at least twice during the financial year, an audit report on the review of the performance management system to the council, as required by municipal planning and performance management regulation 14(4)(a)(iii).
45. The audit committee was not constituted in the manner required by section 166(4)(a) of the MFMA, as none of the members possessed a finance qualification. It did also not meet at least four times a year, as required by section 166(4)(b) of the MFMA.

## Expenditure management

46. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
47. An effective system of expenditure control was not in place, including procedures for the approval, authorisation, withdrawal and payment of funds, as required by section 65(2)(a) of the MFMA.
48. An adequate management, accounting and information system was not in place to recognise expenditure when it was incurred and to account for creditors and payments made, as required by section 65(2)(b) of the MFMA.
49. Reasonable steps were not taken to prevent unauthorised and irregular expenditure, as required by section 62(1)(d) of the MFMA.

## Liability management

50. An adequate management, accounting and information system was not in place to account for liabilities, as required by section 63(2)(a) of the MFMA.
51. An effective system of internal control for liabilities (including a liability register) was not in place, as required by section 63(2)(c) of the MFMA.

## Consequence management

52. Unauthorised and irregular expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a)(ii) of the MFMA.
53. Unauthorised and irregular expenditure was not always recovered from the liable person, as required by section 32(2) of the MFMA.

## Supply chain management

54. Sufficient appropriate audit evidence could not be obtained that all contracts and quotations had been awarded in accordance with the legislative requirements and a procurement process that is fair, equitable, transparent and competitive, as an incomplete commitments register, contract register and general ledger were submitted for auditing.

## **Internal control**

55. I considered internal control relevant to my audit of the financial statements and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for the disclaimer of opinion and the findings on compliance with legislation included in this report.

## **Leadership**

56. Effective leadership, based on ethical business practices and good governance that protected and enhanced the best interest of the municipality, was not demonstrated by top management. The municipal manager was on suspension throughout the entire financial period due to matters relating to alleged fraud.
57. The leadership did not provide adequate direction and oversight with regard to the control environment as it related to financial management and compliance with laws and regulations. Adequate policies had not been developed, reviewed and implemented to guide all significant processes within the municipality.
58. The leadership did not implement effective human resource management to ensure that adequately and sufficiently skilled resources were in place, performance was monitored, and consequence management was applied where necessary.

## **Financial and performance management**

59. The municipality did not maintain a document management system for paper-based and electronic records, or for the timely retrieval thereof. This was evidenced by the annual financial statements not being supported by relevant schedules and supporting documentation and an annual performance report not being submitted. Furthermore, the general ledger and trial balance did not agree to the annual financial statements, and numerous instances of material non-compliance with legislation were noted.
60. There were no review processes to monitor compliance with all applicable laws and regulations within the municipality. As a result, non-compliance with applicable laws and regulations was not effectively identified or prevented and municipal officials were not held accountable for transgressions.
61. The municipality did not have an established performance management system to enable the strategic planning and reporting of performance information. There were no mechanisms to monitor and review the performance management system. These factors contributed to the municipality's failure to submit an annual performance report for auditing.
62. Controls over daily and monthly processing and key reconciliations of transactions were not implemented. There were no processes to monitor compliance with all applicable laws and regulations within the municipality. This resulted in a repeat of significant SCM non-compliance from the prior period.

## **Governance**

63. There was no effective oversight review of financial information, compliance with laws and regulations, and reporting on predetermined objectives.

64. Management was unable to adequately address risks during the period due to a lack of governance.

*Auditor-General*

East London

29 February 2016



**AUDITOR - GENERAL  
SOUTH AFRICA**

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